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THE INTER-ALLIED DEBT: AN ANALYSIS

by

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with the aid of the Research Staff of the Foreign Policy Association

THE almost universal feeling of satisfaction with which the United States greeted the conclusion on July 9 of the Lausanne agreement abolishing German reparation payments was tempered somewhat on the following day by the publication of a supplementary document making ratification of the agreement conditional upon a "satisfactory settlement" of the war debts owed to the United States.[1] Despite the fact that the American government has steadfastly taken the view that there can be no cancellation of the debts and that there is no connection between reparation and war debts, the Lausanne agreement forces a reconsideration of the American position upon an entirely new basis. From 1923, when the first debt-funding agreements were concluded, until July 1931, when the Hoover moratorium went into effect, the European governments had been meeting their obligations to the United States out of the amount received in reparation payments from Germany. Since this source of payments has been permanently removed, our former Allies feel justified in asking a lightening of their own burdens as an essential step toward the restoration of economic stability throughout the western world.

It is perhaps fair to say that the abolition of reparation was brought about only because the creditor nations saw that any attempt to compel Germany to continue payments might cause its financial and economic collapse, with dangerous repercussions throughout the world.[2] It is now an open question whether similar considerations should not lead the United States to make adjustments which would free Europe from the heavy burden to which it is legally committed as a result of the extraordinary expenses connected with the World War.

There is perhaps no question before the American people of such momentous importance, and possibly no subject on which there is such widespread ignorance of the essential facts. It is the purpose of this report to assemble in as convenient a medium as possible the facts pertaining to the American war debts in the hope of promoting an intelligent solution which will aid in the restoration of prosperity throughout the world and, at the same time, carefully conserve American interests.

HOW THE DEBTS WERE CONTRACTED

When the United States entered the war on April 6, 1917, intergovernmental borrowing by the Allies amounted to approximately $8,000,000,000, of which $6,000,000,000[3] had been loaned by Great Britain. Great Britain had been the banker for the Allies and occupied somewhat the same position as that in which the United States found itself after this date.

The United States, a neutral during this period, did not officially participate in any of these financial operations; nevertheless, a part of the Allied credits came from private American sources.[4] The United States was in a position to supply the European governments with most of the commodities essential to the prosecution of the war, including clothing, foodstuffs, machinery and other goods necessary for the maintenance of armies and the support of civilian populations. These goods were paid for by England, in part by selling to Americans large blocks of the securities of American corporations, and in part by the sale of British government bonds and Treasury bills in American markets.

*This report is based in part on "The United States and the War Debts," by Lewis Webster Jones, Foreign Policy Association, *Information Service*, Vol. III, Special Supplement No. 1. All the material of the former report, however, has been carefully revised and brought down to date.

1. For the text of the Lausanne agreements including the so-called "gentlemen's agreement," cf. *Final Act of the Lausanne Conference*, Cmd 4126 and *Further Documents relating to the Settlement reached at the Lausanne Conference*, Cmd 4129 (London, H. M. Stationery Office, 1932).

2. Cf. the statement of the Special Advisory Committee of the Bank of International Settlements, December 23, 1931: "The adjustment of all intergovernmental debts (reparation and other war debts) to the existing troubled situation of the world—and the adjustment should take place without delay if new disasters are to be avoided—is the only lasting step capable of reestablishing confidence, which is the very condition of economic stability." (*Federal Reserve Bulletin*, Washington, Government Printing Office, January 1932.)

3. H. E. Fisk, *Inter-Ally Debts* (New York, Bankers Trust Co., 1924), p. 121.

4. For the extent of American foreign investments in the early years of the war, cf. Max Winkler, "American Foreign Investments in 1931," *Foreign Policy Reports*, Vol. VII, No. 24, February 3, 1932, p. 428.

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By the time the United States entered the war, the Allied governments had reached almost the end of their financial resources and it became apparent that because of its comparative military unpreparedness, the immediate contribution of the United States would have to be a financial one. President Wilson, in his message to Congress on April 2, 1917, called for not only "the utmost practical cooperation, council and action with the the governments now at war with Germany," but also "the extension to these governments of the most liberal credits in order that our resources may so far as possible be added to theirs."

"Contributions to the Common Cause"

Congress acted upon the President's war program almost immediately and the first Liberty Loan Act, authorizing a bond issue of $5,000,000,000 of which $3,000,000,000 was to be loaned to countries "engaged in war with enemies of the United States," was signed by the President and became a law on April 24, 1917. There was nothing in the first Liberty Loan Act nor any of the subsequent Acts passed by Congress which would indicate that the extension of credits to the Allied governments was "a joint contribution to a common cause." The Liberty Loan Acts specifically instructed the Secretary of the Treasury "to enter into such arrangements as may be necessary or desirable for establishing such credits and for purchasing such obligations of foreign governments and for the subsequent payment thereof before maturity."[5] It also authorized the Secretary to apply payments from foreign governments to the retirement of outstanding Liberty bonds. In following out the instructions of the Liberty Loan Acts, the Secretary of the Treasury required the representatives of the borrowing governments to sign promissory notes for their indebtedness in much the same manner as would be required from a borrower in an ordinary commercial transaction. From a purely legal point of view, therefore, it is clear that the advances made to the Allies under the authority of the Liberty Loan Acts were in the nature of loans for which provisions were made for future repayment, and they can in no way be interpreted as gifts on the part of the United States.

There is considerable evidence, however, that the United States would have provided the Allied governments with credits regardless of whether or not they were ever to be repaid. Representative Kitchin, Chairman of the Ways and Means Committee of the House, and the author of the bill, said:

"You will understand that they will be fighting with our money their battles and will be fighting with our money our battles, and too . . . we are of the opinion that most of this money that we will loan to the Allies for the purchase of their arms will have to be expended in the United States."

Representative Fitzgerald, Chairman of the Appropriations Committee, declared:

"I should gladly vote to give $6,000 million to the nations arrayed on the same side with us if we could win this war without sacrificing American blood and American lives. I have little sympathy with the suggestion that possibly we will not get our money back. I care not so much if we do, if American blood and American lives be preserved by the granting of the money."

Congressman Rainey, present Democratic floor leader of the House, stressed much the same idea when he stated:

"We are not making this loan for the purpose of making an investment of our funds. We are making this loan in order to further our interests primarily in this world war and from that moment when the Congress of the United States declared that a state of war existed between this country and Germany every blow struck at Germany by any of her enemies was struck also in our interest."

Senator Smoot of Utah, now Chairman of the Finance Committee of the Senate and a member of the United States Debt-Funding Commission, who negotiated the present debt-funding agreements, declared in the debate in 1917:

"The $3,000 million which we are perhaps to raise by a bond issue advancing it to the Allies, I believe, Mr. President, will all be repaid, but if it should not be, or if not one penny of it is returned, I wish to say that every penny of it will be expended for the defense of the principles in which we believe and which we entered the war to uphold. Mr. President, I believe that every dollar that will be expended under the provisions of this bill . . . will be for the benefit of the United States, whether spent by us or by the Allies."

AUTHORITY FOR LOANS

Between April 1, 1917 and November 30, 1920, the United States loaned a total of $10,338,000,000[7] to 20 different countries in various parts of the world. These loans were given Congressional authority as follows:

1. The Liberty Loan Acts, which authorized the Secretary of the Treasury to make advances to countries engaged in war with enemies of the United States. Congress authorized loans to the extent of $10,000,000,000 under the authority of four successive Liberty Loan Acts:[8]

Act of April 24, 1917	$3,000,000,000
Act of September 24, 1917	4,000,000,000
Act of April 4, 1918	1,500,000,000
Act of July 9, 1918	1,500,000,000

2. Another series of Congressional Acts authorized war supplies and relief loans as follows:
   a. Act of July 9, 1918, authorizing the President, through the head of any executive department, to sell any surplus war supplies on such terms as the head of that department deemed prudent.
   b. The Act of February 25, 1919, which appropriated $100,000,000 as a revolving fund

5. United States, Treasury Department, *Annual Report on State of Finances, 1919-1920.*

7. *Annual Report on State of Finances, 1919-1920,* cited.
8. *Ibid.*, p. 53.

for the participation by the United States, at the discretion of the President, in furnishing foodstuffs and other urgent supplies to certain populations in Europe and contiguous countries.

c. The Act of March 30, 1920, which authorized the United States Grain Corporation, with the approval of the Secretary of the Treasury, to sell the flour in its possession—not to exceed five million barrels—on such terms as might be necessary to relieve the population in certain countries of Europe. The total advances made under the war supplies and relief acts amounted to $740,000,000.

The total advances to foreign governments amounted to $10,350,000,000. Out of this amount $9,610,000,000 was advanced under the authority of the Liberty Loan Acts, of which $7,077,000,000 was advanced before the Armistice and $2,533,000,000 in loans was extended after the signing of the Armistice. Practically all the advances under the war supplies and relief acts were made after the signing of the Armistice.[9] The following table shows the official amounts of pre-Armistice and post-Armistice indebtedness of foreign governments to the United States, and the repayments which were made on the principal up to the date of the funding agreements.

LOANS OF THE UNITED STATES TO FOREIGN GOVERNMENTS*

	Pre-Armistice	*Post-Armistice*				
Country	*Cash Loans*	*Cash Loans*	*War and Relief Supplies*	*Total Indebtedness*	*Repayments of Principle***	*Net Indebtedness*
Armenia ....$	....	$	$11,959,917.49	$11,959,917.49	$	$11,959,917.49
Austria	....	....	24,055,708.92	24,055,708.92	....	24,055,708.92
Belgium	171,780,000.00	177,434,467.89	29,872,732.54	379,087,200.43	2,057,630.37	377,029,570.06
Cuba	10,000,000.00	....	....	10,000,000.00	10,000,000.00	....
Czechoslovakia	....	61,974,041.10	29,905,629.93	91,879,671.03	....	91,879,671.03
Estonia	....	....	13,999,145.60	13,999,145.60[3]	....	13,999,145.60[3]
Finland	....	....	8,281,926.17	8,281,926.17	....	8,281,926.17
France	1,970,000,000.00	1,027,477,800.00	407,341,145.01	3,404,818,945.01	64,689,588.18	3,340,129,356.83
Great Britain	3,696,000,000.00	581,000,000.00	....	4,277,000,000.00	202,181,641.56	4,074,818,358.44
Greece	....	27,167,000.00[2]	....	27,167,000.00[2]	2,922.67	27,164,077.33
Hungary	....	....	1,685,835.61	1,685,835.61	....	1,685,835.61
Italy	1,031,000,000.00	617,034,050.90	....	1,648,034,050.90	364,319.28	1,647,669,731.62
Jugoslavia	10,605,000.00	16,175,465.56	24,978,020.99	51,758,486.55	727,712.55	51,030,774.00
Latvia	....	....	5,132,287.14	5,132,287.14	....	5,132,287.14
Liberia	....	26,000.00	....	26,000.00	26,000.00	....
Lithuania	....	....	4,981,628.03	4,981,628.03	....	4,981,628.03
Nicaragua	....	....	431,849.14[1]	431,849.14[1]	141,221.15	290,627.99[1]
Poland	....	....	159,666,972.39	159,666,972.39	....	159,666,972.39
Rumania	....	25,000,000.00	12,922,675.42	37,922,675.42	1,798,632.02	36,124,043.40
Russia	187,729,750.00	....	4,871,547.37	192,601,297.37	....	192,601,297.37
TOTAL	$7,077,114,750.00	$2,533,288,825.45	$740,087,021.76	$10,350,490,597.20	$281,989,667.78	$10,068,500,929.42

* At the time of funding agreements. Revised to June 30, 1931, in accordance with Annual Report of the Secretary of the Treasury for Fiscal Year Ending 1931. Cf. *ibid.*, 1918, 1919, 1920, 1921, and 1926.

** Includes payments made at time of funding agreements.

1. Includes indebtedness of $265,000 incurred through the purchase of supplies from the United States War Department, March 1, 1927.
2. Includes $12,167,000 advanced at the time of debt-funding agreement, May 10, 1929.
3. Credit of $1,932,923.45 allowed by funding agreement.

The advances to the Allied governments were not made in actual money, but in credits established with the Federal Reserve Bank on which the Allied governments were allowed to draw in order to pay for goods purchased in the United States. Practically the entire amount of advances made by the Secretary of the Treasury was used in purchasing American supplies, and the expenditure of the money loaned to the Allied powers was under the direct supervision of the Treasury Department and a committee of the War Industries Board. The foreign governments were required to report to the United States Treasury an itemized statement of their expenditures, and the Treasury advanced the credit to enable the governments to pay for the materials purchased.

The purposes for which these advances were used is reported by the United States Treasury to have been as follows:[10]

HOW THE CREDITS WERE USED

Munitions, including remounts	$2,493,610,000
Munitions for other governments	205,496,000
Exchange and cotton purchases	2,644,784,000
Cereals	1,422,477,000
Other foods	1,629,727,000
Tobacco	145,101,000
Other supplies	613,107,000
Transportation	136,084,000
Shipping	173,397,000
Interest	730,504,000
Maturities	648,246,000
Relief	538,188,000
Silver	267,943,000
Food for Northern Russia	7,030,000
Purchases from Neutrals	18,719,000
Special Credit against credits to be established for United States government war purchases in Italy....	25,000,000
Miscellaneous	168,530,000
	$11,867,943,000

There has been considerable objection to including in the accounts of the Allied governments certain expenditures which it is claimed were not made strictly for war purposes. In the final analysis, the force of these arguments depends upon what distinction

9. *Ibid.*
10. *Annual Report on the State of Finances, 1919-1920*, cited, p. 338-39.

is made between "commercial" and "war" purposes. In a war such as the last one, which involved the use of the entire resources of the nation, civil as well as military, it is extremely difficult to distinguish between war and non-war expenditures. The National Industrial Conference Board, in their preliminary study, *The Inter-Ally Debts and the United States*, had the following to say in regard to attempts to classify the wartime expenditures into such categories.

> ". . . on careful definition, the distinctions to be drawn between war and non-war purposes seem to have little reality. It is extremely difficult to say what part of the loans might be regarded as having been expended for purposes unconnected with the war or unconnected with the period of American participation in the war. The principal categories usually associated with this idea are: first, pre-armistice expenditures by the European Allied governments in support of their civil populations or for protection of national trade interests; second, expenditures to provide for commitments made prior to the entry of the United States into the war such as interest and maturities; third, all the post-armistice cash advances amounting to about $2,000,000,000 (excluding the portion falling in category 2); fourth, surplus war materials sold abroad after the armistice amounting to about $600,000,000."[11]

All of these expenditures, however, served to strengthen the Allied position, or else benefited the United States directly.

Pre-Armistice and Post-Armistice loans

It has also been suggested that a distinction be drawn between the advances made previous to the signing of the Armistice and those made after hostilities ceased. Despite the fact that the United States remained technically at war with Germany until June 2, 1921, the Treasury has been severely criticized on the ground that it exceeded the powers conferred on it by the Liberty Loan Acts in continuing to grant loans, and also because advances were extended during the post-Armistice period to countries other than those which had been engaged in war with enemies of the United States.

The chief purpose of the United States Treasury in continuing to extend loans to foreign governments after the Armistice was to enable them to carry out contracts previously made for the purchase of American goods, as the Treasury was fearful of the consequences of an immediate cancellation of these large buying orders. Humanitarian considerations also played their part, especially with reference to the loans made to a number of the smaller European governments.[12]

SETTLEMENT OF THE DEBTS

The Liberty Loan Acts authorized Congress not only to make advances to European governments, but also to negotiate the terms on which these advances were to be paid. The obligations received by the United States from the borrowing governments were in the form of ordinary commercial notes bearing interest for the most part at the rate of 5 per cent. From time to time, however, hints were received from the Allied governments regarding the desirability of an all-round cancellation of the inter-Allied debts.[13]

The Congressional attitude toward the payment of the debts was not expressed until February 1922, when Congress passed an act creating a World War Foreign Debt Commission and laid down the principles which were to govern American representatives in the negotiation of debt settlements. The significant features of this Act were the instructions to the American Debt-Funding Commission, which empowered the Commission, with the approval of the President, to fund the war and relief obligations of the various foreign governments "in such form and on such terms, conditions, date or dates of maturity, and rate or rates of interest, and with such security as shall be deemed to the best interest of the United States of America." It was also provided "that nothing contained in this Act shall be construed to authorize or empower the Commission to extend the time of the maturity of any such bonds or other obligations due the United States of America by any foreign government beyond June 15, 1947, or to fix the rate of interest at less than 4¼ per cent per annum." The Act further provided that the Commission had no authority to allow "cancellation of any part of such indebtedness except through payment thereof."[14]

The first change in the attitude of Congress was contained in an act authorizing the British debt settlement. Great Britain was the first debtor nation to send a debt-funding commission to Washington. In the course of the negotiations, held in Washington in January 1923, the British representatives protested that it was impossible for their country to arrange for the payment of the whole indebtedness within the 25 years specified in the Act of Congress creating the Debt-Funding Commission. They also protested against the interest charge of 4¼ per cent which had been stipulated by Congress, in view of the fact that the market rate had

11. *The Inter-Ally Debts and the United States* (New York, National Industrial Conference Board, 1925), p. 50.
12. The assertion attributed to Senator Capper and others (cf. *New York Herald Tribune*, December 27, 1931) that the United States had cancelled the pre-Armistice debts and was only seeking to collect the post-Armistice loans appears to have no foundation in fact. Cf. tables on p. 174 and 178.
13. Cf. David Lloyd George, *The Truth about Reparations and War Debts* (New York, Doubleday, Doran, 1932), p. 104.
14. United States, *Statutes at Large* (Washington, Government Printing Office), Vol. 42, 363.

fallen to about 3½ per cent. Conceding these points, the American Commission accepted a settlement which provided for the funding of the entire amount of the principal and unpaid interest amounting altogether to about $4,600 million over a period of 62 years. Interest was fixed at the rate of 3 per cent for the first 10 years, and 3½ per cent for the remaining 52 years, making the total annual payment, including principal and interest, about $160 million a year for the first 10 years, and about $180 million a year for the remaining 52 years.

In accepting these terms, the American Commission exceeded its authority under the provisions of the Act, and was forced to request an amendment from Congress. This amendment, approved February 28, 1923,[15] marked the first step away from the original policy outlined by Congress, and the British debt settlement was accepted for a time as the basis for negotiations with the other countries.

"Capacity to Pay"

The Act of February 28, 1923 conferred larger discretionary powers upon the American Debt-Funding Commission. In carrying out these powers the Commission formulated the principle of "capacity to pay" as the basis of negotiating debt-funding agreements. This principle, as interpreted by the Debt-Funding Commission, is as follows:[16]

> "While the integrity of international obligations must be maintained, it is axiomatic that no nation can be required to pay to another government sums in excess of its capacity to pay. The Commission in its settlement with Great Britain, made on June 19, 1923, and in subsequent negotiations or settlements has adhered to the principle that the adjustments made with each Government must be measured by the ability of the particular Government to put aside and transfer to the United States the payments called for under the funding agreement.
>
> "Nor does the principle of capacity to pay require the foreign debtor to pay to the full limit of his present or future capacity. It must be permitted to preserve and improve its economic position, to bring its budget into balance and to place its finances and currency on a sound basis, and to maintain, and if possible to improve the standard of living of its citizens. No settlement which is oppressive and retards the recovery and development of the foreign debtor is to the best interest of the United States or of Europe."

THE NATURE OF THE FUNDING AGREEMENTS

In many formal respects the debt-funding agreements with the various European countries are practically the same. Their common characteristics are:[17]

1. Financial clauses which fix the total amount of the funded indebtedness in gold, the interest rate, and the annuities the debtor government will be required to pay.
2. The distribution of these annuities over a period of 62 years.
3. The use of bonds payable to the United States on the part of the debtor government. These bonds are exempt from taxation by the foreign government, and the United States has the privilege of exchanging them with the debtor governments for marketable obligations.
4. The duration of the period in which the debtor may at option suspend payments varies in the different agreements, but all provide for the postponement of payments of principal on a 90-day advance notice. In no case is the period in which payments may be deferred longer than three years.[18]

Of the 20 foreign nations to which the United States made advances during the period between April 1917 and November 1920, 15 have concluded debt-funding agreements with the United States; two nations, Cuba and Liberia, have completely liquidated their debts; and three debts remain unsettled. In the following table are shown the 15 nations which have entered into debt-funding agreements with the United States, the date of the agreement, the original net principal of their obligations, the funded interest, the funded principal and the aggregate interest over 62 years.[19]

FUNDED INDEBTEDNESS OF FOREIGN GOVERNMENTS TO THE UNITED STATES

Country	*Date of Agreement*	*Original Principal (net)*	*Funded Interest*	*Funded Debt*	*Interest for 62-year period*	*Total*
Austria	May 8, 1930	$24,056,000	$559,000	$24,615,000**	$..................	$24,615,000**
Belgium	Aug. 18, 1925	377,029,000	40,750,000	417,780,000	310,050,500	727,830,500
Czechoslovakia	Oct. 13, 1925	91,879,000	23,120,000	115,000,000*	197,811,433	312,811,433*
Estonia	Oct. 28, 1925	12,066,000	1,763,000	13,830,000	19,501,140	33,331,140
Finland	May 1, 1923	8,281,000	718,000	9,000,000	12,695,055	21,695,055
France	April 29, 1926	3,340,516,000	684,483,000	4,025,000,000	2,822,674,104	6,847,674,104
Great Britain	June 19, 1923	4,074,818,000	525,181,000	4,600,000,000	6,505,965,000	11,105,965,000
Greece	May 10, 1929	27,167,000	3,125,000	30,292,000	2,205,000	32,497,000
Hungary	April 25, 1924	1,685,000	253,000	1,939,000†	2,754,240	4,693,240†
Italy	Nov. 14, 1925	1,647,869,000	394,130,000	2,042,000,000	365,677,500	2,407,677,500
Jugoslavia	May 3, 1926	51,037,000	11,812,000	62,850,000	32,327,635	95,177,635
Latvia	Sept. 24, 1925	5,132,000	642,000	5,775,000	8,183,635	13,958,635
Lithuania	Sept. 22, 1924	4,981,000	1,048,000	6,030,000†	8,501,940	14,531,940†
Poland	Nov. 14, 1924	159,666,000	18,893,000	178,560,000	257,127,550	435,687,550
Rumania	Dec. 4, 1925	36,128,000	8,461,000	44,590,000*	77,916,260	122,506,260*
TOTAL		$9,862,317,000	$1,714,943,000	$11,577,261,000*†	$10,623,390,992	$22,200,651,992*†

*Figures now somewhat higher due to deferred payment provided for in funding agreements.
†Figures now somewhat higher due to expense of option to pay part in United States bonds.
**Austrian debt repayable in installments over a 40-year period.

15. *Ibid.*, p. 1325.

16. United States, Treasury Department, *Annual Report on State of Finances, 1924-1925*, p. 53.

The aggregate average annual payments of all the countries that have entered into debt-funding agreements with the United States are shown in the following table:[20]

First 10 years	$233,500,000
Second 10 years	348,000,000
Third 10 years	366,000,000
Fourth 10 years	378,000,000
Fifth 10 years	393,000,000
Last 12 years	414,000,000

CANCELLATION OF INDEBTEDNESS

The original obligations of foreign governments held by the United States Treasury called for a 5 per cent rate of interest and, before the funding of the debts, accrued interest on all these obligations was entered on the books of the Treasury at this rate. At the time the debt-funding agreements were made this accrued interest was cut down by calculating it on a basis of 4¼ per cent in the case of the first settlements, and 3 per cent for a portion of the time in the case of the later settlements. The annual funded principal of the debt was therefore somewhat smaller than the total amount prior to the final agreements. This obviously represents a certain cancellation of the indebtedness of the debtor countries, if the interest rate of 5 per cent is considered to be the "fair" and "normal" rate of interest.

When the debt-funding agreements were negotiated, further cancellations were made by reducing the current rate of interest. In the first series of debt-funding agreements—those with Great Britain, Finland, Hungary, Poland, Estonia, Latvia, Lithuania, Czechoslovakia and Rumania—the interest was fixed at 3 per cent for the first years and at 3½ per cent for the later years, making an average interest rate over the whole period of 62 years of about 3.3 per cent. The average interest rate over the period of 62 years in the case of the other countries is as follows: Belgium, 1.8 per cent; France, 1.6 per cent; Jugoslavia, 1 per cent; Italy, .4 of 1 per cent. No interest was charged Austria on account of its serious financial difficulties.

This reduction of the current interest rate below the original 5 per cent, and again below the rate of 4¼ per cent which was later established by Congress, represents a substantial cancellation of indebtedness if the original rate of interest is taken as the reasonable rate from which interest should be computed. The amount of the cancellation obviously depends on whether interest is computed at 5 per cent, at 4¼ per cent, or at 3 per cent. The Treasury on separate occasions has defended each of these as a "fair" rate of interest.

Three methods have been advanced as a basis for determining a fair rate of interest to charge the European debtor. In the original obligations taken by the United States 5 per cent was stipulated, and Secretary Mellon, in answer to a letter from Mr. Frederick W. Peabody on July 14, 1926, defended the 5 per cent interest rate as follows:[21]

> "Looking at the matter from the standpoint of the debtor nation, the debtor has received a concession in its debt to the extent the interest to be paid by it is below the cost of money to the debtor. The obligations taken by us from our debtors carry the interest rate of 5 per cent per annum. Since this rate is less than most of the debtor nations now have to pay for money, the rate of 5 per cent is certainly a fair share of the real burden put upon them by the settlements. . . .
>
> "France's after-the-war indebtedness with interest amounts to $1,655,000,000. The settlement negotiated by Ambassador Berenger with the American Debt-Funding Commission has a present value of $1,681,000,000."

The second method of arriving at a fair rate of interest is to consider the original cost of money to the United States. The later Liberty Bond issues carried an interest rate of 4¼ per cent. In other words, this was the rate the United States was forced to pay on the money it loaned to the European governments, and is therefore taken as a fair rate for the European governments to pay the United States.

The third manner of determining a fair rate of interest is to consider the cost of money to the United States over a period of 62 years, which has been estimated by Secretary Mellon at about 3 per cent. In this connection it will be recalled that the most recent long-term loan of the United States government, floated in the summer of 1931, bore only 3 per cent interest. In a statement to the Ways and Means Committee of the House of Representatives on May 20, 1926, Secretary Mellon defended the 3 per cent rate as follows:[22]

> "Although the United States has outstanding a substantial amount of Liberty Bonds bearing 4¼ per cent interest, a large part of the government's requirements are now being financed at a much lower rate. The average cost of money to the United States probably will continue to decline. Securities with high interest rates issued during the war will be paid, redeemed or refunded. If we assume that the average cost of money to the United States for the next 62 years will approach a 3 per cent basis, and if we determine the present value of the French annuities on that basis we arrive at a figure which would approximate their actual value today.
>
> "The present value of the French payments on a 3 per cent basis is $2,734 million. This is approximately 82 per cent of the principal amount of the $3,340 million French debt."

17. Reprints of the debt-funding agreements can be found in the annual reports of the Secretary of the Treasury.

18. Only three debtors, Estonia, Latvia and Poland, filed the required 90-day notice for a postponement of the payment on principal due December 15, 1932, following the expiration of the Hoover moratorium. Greece was granted a 2½ year moratorium on July 20, 1932.
The United States at its discretion may waive the required notice but such a waiver must be in writing.

19. United States, Treasury Department, *Annual Report on State of Finances for year ending June 30, 1926,* p. 56; cf. also annual reports for years ending June 30, 1928, and 1930.

20. These figures are only approximate because adjustments have been made to put the dates of payments on a comparable basis.

21. United States Treasury, *Press Release,* July 14, 1926.

22. *Annual Report on State of Finances, 1925-1926,* cited, p. 251.

The following table shows the principal amount of the debts of the various countries having debt-funding agreements with the United States, the total amount to be received over a period of 62 years, and the present value of the debts computed on a basis of a 3 per cent, a 4.25 per cent, and a 5 per cent interest rate. It will be noted that if 3 per cent is used as the cost of money to the United States, eight of the fifteen countries which have funded their debts to the United States are paying more than the total principal and interest at the rate of 3 per cent. It is apparent, therefore, that in the case of these countries there has been no cancellation but, on the contrary, an overcharge of .3 of 1 per cent over a period of 62 years.

PRESENT VALUE OF THE FUNDED DEBTS*

Country	*Average Interest Rate*	*Present Value at 3 per cent*	*Percentage of Overcharge*	*Percentage of Cancellation*	*Present Value at 4¼ per cent*	*Percentage of Cancellation*	*Present Value at 5 per cent*	*Percentage of Cancellation*
Great Britain	3.3	$4,922,702,000	7	....	$3,788,470,000	18	$3,296,948,000	28
France	1.6	2,734,250,000	..	32	1,996,509,000	52	1,681,369,000	58
Italy	0.4	782,321,000	..	62	528,192,000	75	426,287,000	79
Belgium	1.8	302,239,000	..	28	225,000,000	54	191,766,000	60
Poland	3.3	191,283,000	7	....	146,825,000	18	127,643,000	29
Czechoslovakia	3.3	124,995,000	8	....	91,964,000	21	77,985,000	33
Rumania	3.3	48,442,000	8	....	35,172,000	21	29,507,000	34
Jugoslavia	1.0	30,286,000	..	52	20,030,000	68	15,919,000	75
Estonia	3.3	14,798,000	7	....	11,392,000	18	9,915,000	30
Austria	....	....	..	....	10,241,000	70	9,000,000	74
Finland	3.3	9,630,000	7	....	7,413,000	18	6,452,000	30
Lithuania	3.3	6,452,000	7	....	4,967,000	18	4,322,000	30
Latvia	3.3	6,181,000	7	....	4,755,000	18	4,137,000	30
Hungary	3.3	2,076,000	7	....	1,596,000	18	1,388,000	30
TOTAL		$9,175,655,000		20	$6,872,526,000	41	$5,882,638,000	49

*Cf. table 68, page 630, Annual Report of the Secretary of the Treasury for fiscal year ending June 30, 1927.

Unfunded Obligations

Only three of the 20 nations which contracted obligations to the United States government have not made definite arrangement for the settlement of their debts. Of these three, Nicaragua alone is in a position to arrange a funding agreement, since there is no Armenian government and the United States does not recognize the present Soviet government of Russia. Nicaragua made substantial payments on its debt to the United States prior to the revolution of 1927 and had succeeded in reducing its indebtedness to less than $28,000 by June 30, 1926. This was increased by approximately $265,000 in March 1927 by the sale of munitions to the Nicaraguan government by the United States Department of War. Later payments have reduced its net indebtedness to $290,000. Unsettled debts are as follows:[22a]

	Principal (net)	*Accrued Interest*	*Total*
Armenia	$ 11,959,917	$ 7,059,190	$ 19,019,107
Nicaragua..	290,628	62,000	352,628
Russia	192,601,297	125,351,709	317,953,006

Foreign Payments and U. S. Debt Retirement

Regular payments have been made on all war debts as stipulated in the funding agreements through and including the semi-annual payment of June 15, 1931. By this date the total amount received from foreign governments had reached $2,627,580,000—slightly more than one-quarter of the original sum advanced. Of this amount, $725,300,000 represented repayment of principal and $1,902,280,000 interest payments.[23] The law provides that all payments on principal on the cash loans advanced under the authority of the Liberty Loan Acts must be applied for the reduction of the federal debt;[24] provision is also made for the debtors, at their option, to make interest as well as principal payments in United States government obligations instead of cash,[25] which automatically reduces the national debt. Since 1920 the $1,536,966,200 received from foreign governments has been applied to debt reduction. In theory, the remainder has been used to defray current expenses of the government, but in reality it helped swell the large Treasury surpluses which existed between 1920 and 1930 and which were also applied to debt retirement.[26]

THE HOOVER MORATORIUM

For a time no special difficulty was encountered in making regular payments as the debtor countries in most cases were obtaining even greater sums from Germany in

22a. *Annual Report of the Secretary of the Treasury for the Fiscal Year ending June 30, 1931,* p. 551.

23. Cf. *Annual Report of the Secretary of the Treasury for the Fiscal Year ending June 30, 1931,* cited, p. 551.

24. First Liberty bond act (65th Congress, H. R. 2762), sec. 3; Second Liberty bond act (65th Congress, H. R. 5901), sec. 3. Cf. U. S. Treasury Department, *Report of the Secretary of the Treasury, 1917,* p. 84, 93; also *ibid., 1930,* p. 59.

25. When interest payments are made in obligations of our government, these obligations are receivable at par. Until December 1930 foreign governments were able to purchase United States obligations under par and hence paid their interest with these securities. Since then, however, American bonds have been high, and interest payments have been made in cash for the most part.

reparation annuities, which in turn were more than covered by long-term investments in Germany by American private investors. These investments began to fall off in 1929, however, as a result of the American stock market boom, and were even more drastically curtailed in 1931 upon the intensification of the world crisis, with a consequent impairment of Germany's capacity to pay.[27] As a debtor nation substantially dependent on the value of its exports, Germany was especially affected by the catastrophic decline in prices which accompanied the general depression, and found itself practically devoid of resources for the maintenance of external payments.[28] Thus America's debtors were faced with the loss of reparation payments at a time of unprecedented financial stringency.

In order to save Europe from what appeared to be impending financial collapse which would seriously affect the United States, President Hoover proposed on June 20, 1931 "the postponement during one year of all payments on intergovernmental debts, reparations, and relief debts, both principal and interest."[29] This proposal was immediately accepted by Germany, Great Britain and a majority of the debtor nations with the exception of France, which opposed suspension of the unconditional annuities provided under the Young Plan.[30] After negotiation, a compromise was reached with France on July 6, 1931[31] which contained the provision, among others, that the suspended payments should be repayable with interest in 10 annual installments beginning on July 1, 1933.[32]

The following table shows the status of the war debts as stabilized during the period covered by the Hoover moratorium.

PRESENT STATUS OF GOVERNMENT DEBTS OWING TO THE UNITED STATES*

(As of January 1, 1932)

	Amount originally received	*Principal received or to be received under funding agreements*	*Total indebtedness outstanding*	*Payments on Account Principal*	*Payments on Account Interest*	*Total payments to date*
Armenia	$11,959,917	$....................	$19,019,107	$..................	$....................	$....................
Austria	24,055,709	24,614,885	23,752,217	862,668	....	862,668
Belgium	379,087,200	417,780,000	400,680,000	19,157,630	33,033,643	52,191,273
Cuba	10,000,000	....	....	10,000,000	2,286,752	12,286,752
Czechoslovakia	91,879,671	185,071,023	167,071,023	18,000,000	304,178	18,304,178
Estonia	13,999,146	13,830,000	16,466,013	....	1,248,432	1,248,432
Finland	8,281,926	9,000,000	8,604,000	396,000	2,558,685	2,954,685
France	3,404,818,945	4,025,000,000	3,863,650,000	226,039,588	260,036,303	486,075,891
Great Britain	4,277,000,000	4,600,000,000	4,398,000,000	404,181,642	1,507,616,657	1,911,798,299
Greece	27,167,000	32,497,000	31,516,000	983,923	2,108,013	3,091,936
Hungary	1,685,836	1,982,555	1,908,560	73,995	394,471	468,466
Italy	1,648,034,050	2,042,000,000	2,004,900,000	37,464,319	60,120,103	97,584,422
Jugoslavia	51,758,487	62,850,000	61,625,000	1,952,713	636,059	2,588,772
Latvia	5,132,287	5,775,000	6,888,664	....	634,167	634,167
Liberia	26,000	....	....	26,000	10,472	36,472
Lithuania	4,981,628	6,432,465	6,197,682	234,783	893,797	1,128,580
Nicaragua	431,849	....	352,628	141,221	27,562	168,783
Poland	159,666,972	178,560,000	206,057,000	1,287,297	21,359,001	22,646,298
Rumania	37,922,675	66,560,560	63,860,560	4,498,632	263,314	4,761,946
Russia	192,601,297	....	317,953,006	....	8,748,879	8,748,879
TOTAL	$10,350,490,597	$11,671,953,489	$11,598,501,461	$725,300,411	$1,902,280,486	$2,627,580,898

**Annual Report of the Secretary of the Treasury, 1931,* p. 551.

26. MAIN SOURCES OF DEBT RETIREMENT
(For fiscal years 1920 to 1931)

June 30	*Sinking Fund*	*Foreign Repayments*	*Surplus of Receipts*
1920	$	$ 72,669,700	$ 212,475,197
1921	261,100,250	73,939,300	86,723,772
1922	276,046,000	64,837,900	313,801,651
1923	284,018,800	100,892,950	309,657,460
1924	295,987,350	149,387,600	505,366,986
1925	306,308,400	159,179,600	250,505,238
1926	317,091,750	169,653,500	377,767,817
1927	333,528,400	179,216,300	635,809,922
1928	354,741,300	181,804,050	398,828,281
1929	370,277,100	176,213,500	184,787,035
1930	388,368,950	160,925,850	183,789,215
1931	391,660,000	48,245,950	*902,716,845
Totals	$3,579,128,300	$1,536,966,200	$2,556,695,729

*Deficit.

Compiled from *Report of the Secretary of the Treasury, 1931,* cited, p. 536.

27. For details, cf. the following annual reports covering American investments: Max Winkler, "The Dollar Abroad," Foreign Policy Association, *Information Service,* Vol. V. Supplement No. 1, March 1929; *idem,* "Prosperity and Foreign Investments," Foreign Policy Association, *Information Service,* Vol. VI, Supplement No. 1, May 1930; *idem,* "American Foreign Investments in 1931," *Foreign Policy Reports,* Vol. VII, No. 24, February 3, 1932; also *World Economic Survey, 1931-1932,* League of Nations, Geneva, p. 39.

28. Cf. M. S. Wertheimer, "The Financial Crisis in Germany," *Foreign Policy Reports,* Vol. VII, No. 26, March 2, 1932, p. 461-64.

29. For text, cf. James W. Angell, "Reparation and the Inter-Ally Debts in 1931," *Foreign Policy Reports,* Vol. VII, No. 4 (Revised Edition), August 1931, p. 99; or *New York Times,* June 21, 1931.

30. Cf. Wertheimer, "The Financial Crisis in Germany," cited, p. 464-5.

31. For text, cf. Angell, "Reparation and the Inter-Ally Debts in 1931," cited, p. 100.

32. The final step was taken in May and June 1932, when the deferred payments were funded by separate agreements between the United States and each of the debtor nations at the rate of interest stipulated by Congress—4 per cent. Repayment is to be in 10 installments totalling $30,048,862.38 annually, beginning on July 1, 1933.

American Debt Policy Since the Moratorium

As the effects of the world crisis became more severe, American policy toward the inter-Allied debts has vacillated in a manner indicative of the sharp differences of opinion throughout the country. There has been evidence of a growing feeling that further adjustment would be necessary as a result of the world-wide economic dislocation. In his proposal for a one-year moratorium, President Hoover declared that the "abnormal situation now existing in the world" must be taken into account, and that the United States must not "extract any sum beyond the capacity of any debtor to pay." Further reflections of this view may be found in the statement issued following the Hoover-Laval conversations in October 1931, in which Mr. Hoover appears to have agreed in principle to the re-examination of war debts after the European powers had granted a reduction in reparation.[33] In pursuance of this policy, the President proposed, in his annual message to Congress on December 10, 1931, that the World War Foreign Debt Commission be re-constituted, with authority to reconsider the terms of the debt settlement of the various nations in the light of the world economic emergency.[34] The majority in Congress, however, backed by public opinion, has steadfastly opposed either cancellation or reduction of the debts. In ratifying the one-year moratorium, Congress deliberately ignored the President's suggestion for re-creating the debt commission, and inserted the following statement of policy.

> "Section 5. It is hereby expressly declared to be against the policy of Congress that any of the indebtedness of foreign countries to the United States be in any way cancelled or reduced, and nothing in this joint resolution shall be construed as indicating a contrary policy, or implying that favorable consideration will at any time be given to a change in policy hereby declared."[36]

The view of Congress was also reflected in the five-point memorandum sent to the French government in January 1932 summarizing American policy on the war debts.[37] Since that time, however, there are indications that American policy has tended to become somewhat less inflexible, so as not to definitely rule out the possibility of revision. It is particularly significant that the platform of the Republican party, adopted at Chicago in June 1932, makes no reference to the war debts. The Democratic platform opposes "cancellation of the debts owing the United States," but does not commit the party regarding reduction or revision of these debts.

The Presidential candidates have been somewhat more specific. In his speech accepting renomination, Mr. Hoover held out the possibility of adjustment when he said:

> "If for any particular annual payment we were offered some other tangible form of compensation, such as the expansion of the markets for American agriculture and labor, and the restoration and maintenance of our prosperity, then I am sure that our citizens would consider such a proposal. But it is a certainty that these debts must not be cancelled or the burdens transferred to our people."[38]

Speaking before the New York State Grange on February 2, 1932, Governor Roosevelt suggested that the debtors be summoned to a meeting in this country to determine "when payments should begin and in what amounts."[39] In interpreting his party's platform, Mr. Roosevelt linked the debts with our national trade policy when he declared:

> "The debts will not be a problem—we shall not have to cancel them if we are realistic about providing ways in which payment is possible through the profits arising from the rehabilitation of trade. . . . Our policy declares for payment, but at the same time for lowered tariffs and resumption of trade which open the way for payment."[40]

In the meantime Senator Borah, Chairman of the Senate Committee on Foreign Affairs, declared in a radio address on July 23:

> "A new situation has arisen . . . if the policies initiated at Lausanne are carried forward, there will come a time when it will be distinctly to the interest of the people of the United States to consider again the question of these debts. . . . I entertain the belief that the cancellation of the debts in connection with, and as a part of, a program, including the settlement of other war problems [armaments and war guilt], would have the effect above indicated [open foreign markets, cause a rise in prices, put an end to unemployment and thaw out the banks' frozen credits]."[41]

WAR DEBTS AND ARMAMENTS

During the debate on the Hoover moratorium in Congress, Senator Johnson and several members of the House of Representatives pointed out that the debtor nations were spending approximately eight times as much for armament as would be required to meet the payments on their debt to the United States.[42] In many cases the increase in armament expenditures since 1913 has been greater than the annual debt payments, as will be seen in the following table.

33. For the text of the statement, cf. *Current History*, December 1931, p. 421. Cf. also P. J. Philip, "Lausanne Results," *New York Times*, August 28, 1932.
34. Cf. *New York Times*, December 11, 1931.
36. House Joint Resolution 147, *Congressional Record*, Vol. 75, No. 10, December 18, 1931, p. 807.
37. The American position was stated as follows: (1) There must be no connection between war debts and reparation; (2) The initiative on reparation must come from Europe; (3) An extension of the one-year moratorium would not be approved by Congress, while the Senate opposes either cancellation or reduction of the inter-Allied debts; (4) The United States would look with displeasure upon the formation of a "united front" by the debtor nations; (5) The existing debt agreements, having been concluded separately, can only be revised by individual negotiations with each of the debtor states. (Cf. *New York Times*, January 21, 1932.)
38. *New York Herald Tribune*, August 12, 1932.
39. *New York Times*, February 3, 1932.
40. Radio address from Albany, July 30, 1932. (Cf. *New York Times*, July 31, 1932.)
41. *New York Times*, July 24, 1932.
42. Cf. remarks by Senator Johnson, *Congressional Record*, Seventy-Second Congress, First Session, December 22, 1931, p. 1085-86; also speeches of Congressmen Crisp, Eslick, and Parsons, *Ibid.*, December 18, 1931, p. 815, 817-18, 860-61.

ARMAMENT EXPENDITURES COMPARED WITH WAR DEBT PAYMENTS TO THE U. S.*

(In millions of dollars)

	Total Expenditures 1931	Expenditure for Armaments 1913	1931	% of Budget 1931	Scheduled War Debt Payments 1931	% of Budget 1931
Great Britain	$3,889	$375.1	$527.5	13.6	$159.4	4.1
France	1,975	348.7	541.3	27.4	40.0	2.0
Italy	1,095	179.1	331.6	33.1	14.6	1.4
Belgium	363	....	41.2†	11.3	7.3	2.0
Poland	322	....	94.9	29.5	6.2	1.9
Total			$1,536.5		$227.5	
United States	4,438	244.6	727.7	16.5		

*For armament figures, cf. William T. Stone, "The Burden of Armaments," *Foreign Policy Reports,* Vol. VII, No. 20, December 9, 1931.

†For 1930.

The Transfer Problem

While it is true that from the point of view of the budget there is no difference between expenditures for defense and payments on the inter-Allied debts, the effect upon the nation's financial position is by no means the same. Strictly speaking, the two are incomparable. Armament expenditures involve merely a redistribution of the national income, while debt payments involve the necessity of transferring value to a foreign country. This has proved to be the crucial problem in connection with all international debts. It is not enough to raise money by internal taxation: if the payment is to be made in money form, it is necessary for the debtor nation to obtain enough foreign exchange to meet the payment. In practice this can be done in only four ways—by the export of goods, services, gold or securities. Since international obligations of this magnitude obviously cannot be liquidated by the shipment of gold, there remains only the possibility of payment in goods or services, or the temporary expedient of obtaining new loans large enough to cover interest and amortization charges.

It follows that if the debtor nation is to maintain an export surplus of goods and services, the creditor nation must import more than it exports. This process need not consist of a direct exchange of goods and services between the debtor country and the United States. France, for example, may buy sterling, sell it to London for dollars and then transfer the dollars to the United States. The important fact is that the debtor nation must have an export balance on the total of visible and invisible items, and the United States, as the creditor nation, must have an import balance.[43]

In actual practice, however, the international commercial policy of the United States has effectively prevented payment in goods or services.[44] Imports have been seriously restricted by a high tariff wall, while exports have been vigorously promoted by governmental and private agencies. Service payments have been similarly limited by immigration and merchant marine laws. Debt payments, consequently, have been made possible only through the exchange obtained by private borrowing in the United States. The net capital export of the United States from 1920 to 1930, covered by the import of foreign securities, was $6,172,000,000 which was more than three times the net return from the war debts during the same period—$1,888,000,000. The only result of this process has been to reduce the amount of government indebtedness by increasing the indebtedness to the United States on private account.

43. For a detailed discussion of this problem, cf. M. S. Stewart, "American Commercial Policy and the World Crisis," *Foreign Policy Reports,* Vol. VIII, No. 6, May 25, 1932.

44. *Ibid.*

COST OF CANCELLATION TO AMERICAN TAXPAYERS

Although it is fair to say that cancellation of the intergovernmental debts would place an increased direct burden on the American taxpayer, the amount involved is not as great as is commonly supposed. The installment due during the fiscal year 1932-1933 is slightly less than $270,000,000, or $2.20 per capita of the American population.[45] Moreover, the direct loss of income resulting from a discontinuance of debt payments would be offset, partially at least, by the increase in revenue accompanying improved business conditions.[45a] The losses in customs duties alone since the outset of the depression, despite the increased rates provided by the Hawley-Smoot tariff, have been greater than the annual payments due on the war debts.[46]

45. The American taxpayer is already spending more than two and a half times as much for armament ($727,000,000) as the income from the debts, and an even greater amount ($738,000,000) for veterans' relief. (Cf. Stone, "The Burden of Armaments," cited, p. 380, and *New York Times,* June 12, 1932.)

45a. Cf. Harold G. Moulton and Leo Pasvolsky, *War Debts and Prosperity* (Washington, Brookings, 1932), p. 422.

46. Receipts from customs duties declined from $602,000,000 in the fiscal year ending June 20, 1929, to $378,000,000 in the year ending June 30, 1931, and $328,000,000 in the past year—a loss of $224,000,000 and $274,000,000 respectively. The amount received on war debts in the year ending June 30, 1931 was $236,000,000, while the amount to have been received this past year was $246,566,803. (Cf. *Annual Report of the Secretary of the Treasury for 1931,* cited, p. 79, 83, 453; and Secretary Mills' review of the fiscal year 1932, *New York Times,* July 2, 1932.)

SHOULD THE WAR DEBTS BE CANCELLED?

There are few subjects on which there is such sharp disagreement as exists regarding the advisability of cancellation of the war debts by the United States. The argument for cancellation may be summarized in six points:

1. The inter-Allied debts are unlike most private debts in that they have no assets arising out of them to provide means for repayment.[47] Commercial loans are for the purpose of providing resources which increase the productivity of the borrower and thereby assure repayment; in contrast, the resources provided by the war loans were for the most part expended in wholly nonproductive channels. The war debts, therefore, constitute a permanent burden upon the productive capacity of the debtor countries since repayment can be effected only by setting aside a certain portion of the national income to meet service charges.

2. The decline in the price level since the debts were contracted has been so severe as to make the burden more than twice as heavy in terms of goods and services as was anticipated.[48]

3. Although theoretically there is no connection between the inter-Allied debts and German reparation payments, in practice the two are inseparable. The claims of the Allied nations for reparation were strongly influenced by the necessity of meeting war debt payments;[49] the schedule of reparation payments under the Young Plan was drawn up to provide for the debt payments arranged under the funding agreements; and the relief granted at Lausanne was made conditional on a reduction of the war debts.[50] Stability cannot be restored in Europe until the whole superstructure of the war indebtedness is wiped away.

4. The attempt to collect reparations and the inter-Allied debts has caused a steady flow of international payments from an impoverished Germany to the United States and France which, because of tariffs, quotas and other trade barriers, has led to a maldistribution of gold and a consequent deflation of prices throughout the world.[51]

5. In view of the conditions mentioned above and the difficulty of effecting transfers into foreign currencies,[52] it is very unlikely that full debt payments will or can be made in the future, and definite cancellation on the part of the United States would do much to restore the good will and business confidence which is necessary to world economic recovery.

6. Cancellation would be advantageous to the United States as well as to the debtor countries because it would aid in the restoration of economic stability and provide a stimulus to American trade. Europe is one of the largest customers of the United States and the ability to buy American products will be directly affected by the amounts they are required to pay on their debts to the United States.[53]

The case against cancellation of the debts can be summarized as follows:

1. The war debts represent the solemn obligations of the various governments concerned, entered into voluntarily for value received. Either default or cancellation would jeopardize the basis of international credit and make difficult any form of international contracts in the future.
2. There is no connection between reparation and the inter-Allied debts.[54] The plight of Germany and the possibility of its continuing the payment of reparation is entirely a European problem.
3. Europe's ability to pay is established by the fact that all of the debtor countries spend much more on armaments each year than is required for debt payments, while in many instances the increase in armament expenditures since 1913 is greater than the total required for the debts.
4. The United States has already been exceptionally generous to the debtors, and has cancelled a large part of the debts and adjusted them in accordance with the capacity of each nation to pay.[56]
5. Cancellation or reduction of the war debts would be tantamount to shifting the honest debts of the European nations to the shoulders of the American taxpayers.[57] This would lead to a sharp rise in taxation at a period when it is urgently necessary to lighten the burden of taxation in order to stimulate business recovery.
6. There is no assurance that the sums saved by cancellation of the debts would not be applied to war preparations which would endanger the entire world.

In addition to those taking an extreme position for or against the cancellation of the debts, there is a growing number of persons who favor a revision of all inter-governmental obligations either on the basis of the changed purchasing power of gold or on a basis comparable to that reached at Lausanne in regard to reparation payments. It has been suggested by some that the re-examination of the obligation of the debtors in accordance with the principle of "capacity to pay" as accepted by Congress in 1923 might yield an equitable solution to the problem.[60] Others, as we have already seen, would grant reduction or cancellation of the debts in return for European disarmament or trade concessions advantageous to the United States. The final settlement will have to take into consideration not only such tangible facts as the economic status of Europe, but such intangibles as the uncharted currents in American political life, as well as the prejudices and divergent opinions of the American people.

47. Cf. G. D. H. Cole and R. S. Postgate, "War Debts and Reparations," *New Statesman and Nation* (London), p. 5-6.
48. The index number of wholesale prices of the United States Bureau of Labor Statistics (1926=100) was 65.5 in April 1932, as compared with 131.3 in 1918 and 138.6 in 1919.
49. Cf. Lloyd George, *The Truth about Reparations and War Debts*, cited, p. 96-121.
50. Cf. Lewis Webster Jones, "The Young Plan Settlement," Foreign Policy Association, *Information Service*, Vol. V, No. 12, August 21, 1929, p. 206, 213.
51. Cf. Sir Henry Strakosch, "The Crisis," supplement to *The Economist* (London), January 9, 1932; cf. also *Report of the Gold Delegation of the Financial Committee of the League of Nations* (Geneva), June 1932, p. 21, 61-67, 70.
52. Cf. p. 181.
53. In this connnection, cf. the suggestion of former Governor Alfred E. Smith to write off as paid each year 25 per cent of the gross value of the American products purchased by the debtor nations. (*New York Times*, April 14, 1932.) Cf. also President Hoover's statement in his speech accepting the renomination for the Presidency, p. 180.
54. Cf. the memorandum sent to the French government regarding American policy on the war debts, *New York Times*, January 21, 1932.
56. Cf. speech of Representative Crisp, *Congressional Record*, December 18, 1931, p. 815; cf. also p. 180-181.
57. Cf. speech of Representative Eslick, *Congressional Record*, December 18, 1931, p. 818.
60. Cf. editorial, *The World Tomorrow*, August 1932. Cf. also, "The President Proposes a Debt Moratorium," *Foreign Policy Bulletin*, Vol. X, No. 34, June 26, 1931.